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## **78<sup>TH</sup> LEGISLATURE TACKLES HOMEOWNERS INSURANCE CRISIS**

As the 78<sup>th</sup> Legislature convened in January 2003, legislators faced a crisis in Texas' homeowners insurance market. Calling the issue a top priority, Governor Rick Perry declared it a legislative emergency, allowing legislators to begin work on a remedy immediately upon convening.

Many feel that the crisis that began in early 2000 had its genesis in a sudden proliferation of mold claims against Texas homeowners' policies. At that time, approximately 95 percent of the homeowners insurance market was carried by insurance companies exempt from rate regulation in Texas, such as Lloyds and reciprocal exchanges. A November 2001 order issued by Commissioner of Insurance (commissioner) Jose Montemayor to address the recent mold-related developments explains that the problem was exacerbated by

*the fact that the most commonly purchased Texas policy, Texas Homeowners Form-B (HO-B), which is presently a promulgated and standardized form, that provides the most expansive coverage, of all the states, for water damage and any ensuing mold and fungi losses. [sic] Texas also leads the nation as the most costly venue for homeowners insurance. This currently is due to the Texas standard policies' generous coverage for water damage losses as well as extreme weather-related losses.*

According to Texas Department of Insurance (TDI) figures collected from Texas' three largest issuers of homeowners insurance policies, the cost of mold-related claims jumped from \$9.1 million in the first quarter of 2000 to \$79.5 million in the first quarter of 2001.

Along with rising claims costs came escalating premium rates, which, as noted above, were largely unregulated and therefore beyond the reach of the oversight authority of TDI. Skyrocketing rates led to increased complaints, including anecdotal complaints of increases of up to 200 percent. TDI estimates that homeowners' rates have increased statewide an average of 45 percent since 2000.

There was also concern over the growing use of credit scoring in insurance and its effect on rates. Insurers began suspending or limiting new homeowners' policies, and some insurers threatened to withdraw completely from the Texas insurance market. Cumulatively, these issues created a statewide coverage availability concern.

All of these developments contributed to the crisis facing legislators at the start of the legislative session. Before adjournment on June 2, 2003, the 78<sup>th</sup> Legislature had enacted homeowners insurance measures addressing rating systems, policy forms, underwriting guidelines, credit scoring, claims handling procedures, availability, mold remediation, and homebuilding regulation. This publication outlines the bills relating to homeowners insurance passed during the regular session of the 78<sup>th</sup> Legislature.

*In cases where a bill addresses areas other than homeowners insurance, the bill's summary only addresses the portion of the bill that relates to homeowners insurance.*

### HIGHLIGHTS

**S.B. 14 by Senator Jackson, et al./Representative Smithee, et al.** Relating to certain insurance rates, forms, and practices; providing penalties.

Brings all licensed auto and residential property insurers under TDI's rate regulation authority.

#### Rating System in Effect Until December 1, 2004:

Provides that residential property rates will be subject to prior approval by the commissioner, with a 30-day period after which, if no action is taken by the commissioner, rates are deemed approved.

Authorizes the commissioner by rule to simplify filing requirements for small insurers and new insurers.

#### Rating System in Effect After December 1, 2004:

Provides that residential property insurance rates become regulated under a file-and-use system. File-and-use refers, generally, to a system whereby

insurers may use rates upon filing them with the commissioner.

#### Other Major Provisions:

Authorizes the commissioner to require refunds when filings indicate that excessive rates have been charged.

Prohibits an insurer from using rating territories that subdivide a county unless the rate for any subdivision within that county is not more than 15 percent higher than the rate used in any other subdivision in the county by that insurer.

Authorizes the commissioner by rule to allow a greater rate difference between rating territories for residential property insurance or personal automobile insurance.

Authorizes all insurance companies, rather than only national companies, to file alternative residential policy forms for TDI approval.

Requires insurers that use credit scoring to file their credit scoring models with TDI and provides that those models are public information, are not subject to any exceptions to disclosure under Chapter 552 (Public Information), Government Code, and cannot be withheld from disclosure under any other law.

Sets forth prohibitions on certain uses of credit scoring in insurance, including: prohibiting the use of credit information as the sole basis for denying, canceling, or renewing a policy; and limiting the type of information that may be incorporated into a credit score.

Requires TDI to issue rules limiting how much an insurer's rates may vary solely because of differences in credit scores.

Provides that upon request from a consumer, an insurer may grant exceptions for negative credit information arising from extraordinary events such as catastrophic illness, unemployment, and identity theft.

Requires all companies writing personal auto and residential property insurance to file their

underwriting guidelines with TDI and update them each time the guidelines are changed. Provides that underwriting guidelines are subject to Chapter 552, Government Code.

Requires all insurers to comply with provisions requiring plans of orderly withdrawal from the Texas market. Authorizes the commissioner to modify, restrict, or limit a withdrawal plan, if necessary to protect consumers.

Provides for the issuance of up to \$75 million in bonds if necessary to fund the Texas Fair Plan Association, the nonprofit association established to develop and administer a program to provide residential property insurance in designated underserved areas in this state.

Provides that a person commits a state jail felony offense if the person recklessly offers or collects race-based premiums.

Sets forth provisions for the establishment of the Property and Casualty Insurance Legislative Oversight Committee to receive information about rules proposed by TDI relating to property and casualty insurance and to monitor the progress of property and casualty insurance regulation reform, including the fairness of rates, underwriting guidelines, and rating manuals, the availability of coverage, and the effects of rate rollbacks, credit scoring, and the regulation of homeowners and automobile insurance markets.

Reduces the period during which an insurer may cancel a newly issued homeowners policy from 90 days to 60 days and specifies the circumstances under which an insurer is allowed to cancel a policy within the first 60 days.

**S.B. 113 by Senator Van de Putte, et al./ Representative Seaman.** Relating to premium discounts for certain residential property insurance policies.

Authorizes an insurer that issues a residential property insurance policy in Texas to provide a discount of not less than three percent on the premiums that would otherwise be charged for the policy if the policyholder has continuously been a

residential property insurance policyholder with that insurer or an affiliate of that insurer but has not filed a residential property insurance claim during the three years before the effective date of the policy.

Authorizes an insurer that issues a residential property insurance policy in Texas to increase the amount of the discount by one percent for each subsequent year in which the policyholder has been a policyholder of that insurer but has not filed a residential property insurance claim.

Provides that an insurer that provides a discount under these provisions is not required to provide a discount that exceeds 10 percent of the premiums that would otherwise be charged for the residential property insurance policy.

Requires the commissioner to adopt rules as necessary to implement this Act and to establish guidelines for discounts.

Authorizes the commissioner to approve a discount filed with TDI that is different from the discount specified by this Act, if the commissioner determines the discount is actuarially justified.

**S.B. 115 by Senators Van de Putte and Barrientos/ Representative Seaman.** Relating to providing consumers with information regarding policy forms for residential and farm and ranch property insurance coverage.

Requires an insurer, including a farm mutual insurance company, county mutual insurance company, Lloyds plan, or reciprocal or interinsurance exchange, that renews a policy of homeowners insurance, fire and residential allied lines insurance, or farm and ranch insurance to provide the policyholder with written notice of any difference between each form of the renewal policy and the form held immediately before renewal.

Requires a notice provided under these provisions to be written in plain language.

Requires the commissioner to promulgate a comparison form for certain policy forms and endorsements approved by the commissioner.

Requires the comparison form to be developed with the assistance of the Office of Public Insurance Counsel and with input from the public and to be designed to explain the features and limitations of the policy compared to other approved policies.

Provides that an insurer using a policy form may be required to develop the comparison form and submit it to the commissioner for approval.

Requires the comparison form to be made available by an insurer to anyone inquiring about the policy and to be made available by TDI via the Internet and other means as prescribed by the commissioner.

**S.B. 127 by Senator Fraser, et al./Representative Seaman.** Relating to the handling, settling, and use of certain claims in the insurance business; providing penalties.

Sets forth restrictions on the use of claims history for water damage in order to protect persons and property from being unfairly stigmatized in obtaining residential property insurance for filing a water damage claim or claims under a residential property insurance policy.

Prohibits an insurer from using a prior appliance-related water claim in rating or underwriting, if the problem that caused the claim has been properly remediated.

Sets forth provisions for the regulation of water damage claims handling procedures and time frames to provide for the prompt, efficient, and effective handling and processing of water damage claims, to reduce the confusion and inconvenience policyholders experience in filing and resolving water damage claims, and to reduce claim costs and premiums for residential property insurance issued in this state.

Authorizes the commissioner by rule to regulate the following aspects of water damage claims: required notice; acceptance and rejection of a claim; claim handling and processing procedures and time frames; claim investigation requirements, procedures, and time frames; settlement of claims; and any other area of claim processing, handling, and

response determined by the commissioner to be relevant and necessary.

Sets forth provisions for the licensure and practice of public insurance adjusters.

Requires public adjusters to be licensed by TDI and makes examination and continuing education a requirement of licensure.

Requires the commissioner to adopt a code of ethics for public adjusters.

Prohibits a public adjuster's commission from exceeding 10 percent of the amount of the insurance settlement on a claim.

Prohibits a public adjuster from receiving a commission based on the amount of a settlement when the insurer pays or agrees to pay policy limits within 72 hours after a loss is reported.

**S.B. 310 by Senator Fraser, et al./Representative Smithee, et al.** Relating to rate information to be filed by certain insurers of residential property; providing an administrative penalty.

Requires that, on a one-time basis, insurers writing residential property insurance in this state file rates and supporting data, including current rates and estimated rates to be charged in the six-month period following the effective date of the Act (February 25, 2003), with the commissioner for the purpose of preparing a summary report for submission to the 78th Legislature.

Requires the report to contain a review of the rates, presented in a manner that protects the identity of individual insurers, to inform the 78<sup>th</sup> Legislature as to whether the rates are just, adequate, and reasonable and not excessive or unfairly discriminatory, and to assist in the determination of the most effective and efficient regulatory system for residential property insurance in Texas.

Requires the commissioner to notify the governor, the lieutenant governor, the speaker of the house of representatives, and the members of the legislature of the names of the insurers that were asked to make



the rate filings under this Act and the names of the insurers that did not respond in whole or in part to the commissioner's request.

Provides that an insurer that fails to comply with any request for information issued by the commissioner under this Act is subject, after notice and opportunity for hearing, to certain sanctions.

**S.B. 581 by Senators Jackson and Van de Putte/ Representative Marchant.** Relating to an optional discount in homeowners insurance premiums for the use of an insulating concrete form system.

Authorizes an insurer to grant a discount, in accordance with the rules adopted by the commissioner, in an applicant's homeowners insurance premiums for covered property constructed with an insulating concrete form system, upon receipt of written verification of the use of such a system.

Requires the commissioner to adopt rules to prescribe the requirements for determining that a structure has been built using an insulating concrete form system.

Provides that the rules may require, if the commissioner considers it necessary, an applicant to pay for an inspection of the property to be insured.

Requires the commissioner to establish by rule the amount of the premium discount applicable.

Gives the commissioner the discretion to approve a discount greater than or less than the discount established under these provisions in certain circumstances.

**S.B. 1606 by Senators Ellis and Lucio/ Representative Taylor.** Relating to residential property insurance provided under the FAIR Plan Act.

Establishes a temporary provision effective until September 1, 2005, that authorizes the commissioner to establish a Fair Access to Insurance Requirements (FAIR) plan to deliver residential property insurance to citizens of this

state in underserved areas if the commissioner determines that in all or any part of the state residential property insurance is not reasonably available in the voluntary market to a substantial number of insurable risks.

Decreases from 50 to 25 the percentage of qualified applicants to the residential property market assistance program who have not been placed with an insurer in the previous 6 months (formerly 12 months) as one of the determinants for establishing a FAIR Plan.

**H.B. 329 by Representative Naishtat, et al./ Senator Fraser.** Relating to the regulation of mold assessors and remediators, civil liability for mold remediation, and insurance coverage on mold claims; providing civil and administrative penalties

Enacts Chapter 1958 (Mold Assessors and Remediators) of the Occupations Code. Provides that Chapter 1958 applies only to the regulation of mold-related activities that affect indoor air quality.

Requires the Texas Department of Health (TDH) to administer these provisions to protect the public from the adverse health effects of mold.

Requires TDH to conduct a statewide education and outreach program regarding air quality in buildings, including recognizing, preventing, controlling, and mitigating mold occurrences and other indoor air quality factors that adversely affect human health. Authorizes TDH to contract with governmental entities or other persons to provide the program.

Requires the Texas Board of Health (board) to adopt substantive and procedural rules as necessary or desirable in order for the board, TDH, and commissioner of public health to discharge their powers and duties under this Act.

Requires the board by rule to establish minimum performance standards and work practices for conducting a mold assessment or mold remediation in this state.

Requires TDH to conduct inspections as necessary to ensure compliance with this Act.

Requires the board to adopt rules regarding compliance investigations and requires TDH to investigate any complaint regarding mold-related activities.

Sets forth provisions for the establishment of mold safety standards.

Requires the board by rule to adopt a code of ethics for license holders that promotes the education of mold assessors and mold remediators with regard to the ethical, legal, and business principles that should govern their conduct.

Sets forth provisions for the licensing and registration of persons performing mold assessment and mold remediation, including provisions relating to exemptions, employee registration, license application, examination, training, continuing education, and reciprocity.

Sets forth guidelines for practice by a license holder, including provisions relating to a scope-of-work analysis, a remediation work plan, notice requirements, certification of mold remediation, conflicts of interest and disclosure, records requirements, and office location.

Prohibits an insurer from making an underwriting decision regarding a residential property insurance policy based on previous mold damage or a claim for mold damage, if certain conditions are met relating to the proper assessment and remediation of mold damage.

**H.B. 730 by Representative Ritter, et al./Senator Fraser.** Relating to residential construction, including certain warranties, building and performance standards, and dispute resolution; providing an administrative penalty.

Enacts Title 16, Property Code, the Texas Residential Construction Commission Act.

Establishes the Texas Residential Construction Commission (TRCC) and sets forth provisions regarding appointment of the nine members of the

TRCC by the governor, terms of office, requirements for membership and employment, grounds for removal, training, and meetings.

Sets forth provisions regarding the powers and duties of the TRCC, which include rulemaking authority, fees, and reporting.

Sets forth guidelines for the TRCC's public interest information service and complaint procedures.

Sets forth provisions regarding builder registration, which include application for a certificate of registration, provisional registration, fees, eligibility requirements, denial of registration, expiration of certificate, office location, and designation as a "Texas Star Builder," whereby a builder may represent to the public that the builder meets all of the requirements and qualifications set forth by the TRCC.

Sets forth provisions regarding the certification of residential construction arbitrators, which include application, fees, notice and public comment periods, denial of certification, expiration of certification, and the maintenance of a list of certified arbitrators.

Sets forth guidelines for prohibited practices and disciplinary proceedings, which include grounds for disciplinary action, disciplinary powers of the TRCC, hearings, and appeal.

Sets forth provisions regarding the imposition of an administrative penalty not to exceed \$5,000 for each violation.

Requires a builder to register new homes and home transactions with TRCC.

Sets forth provisions regarding a state-sponsored inspection and dispute resolution process, which include request for resolution, a builder's right of inspection, inspection by a third-party inspector, inspector's recommendations, and threats to health or safety.

Requires a homeowner to comply with the Act's provisions regarding a state-sponsored inspection and dispute resolution process, a statutory warranty,

and building and performance standards before initiating an action for damages or other relief arising from an alleged construction defect.

Sets forth provisions regarding qualifications, functions, and duties of third-party and state inspectors and guidelines for the appeal of a third-party inspector's recommendations.

Sets forth provisions regarding warranties and building and performance standards.

Requires TRCC by rule to adopt limited statutory warranties and building and performance standards for residential construction according to statutory guidelines.

Provides that the warranties established under these provisions supersede all implied warranties.

Provides that the only warranties that exist for residential construction or improvements are the warranties created by these provisions or by other statutes expressly referring to residential construction or improvements, or any express, written warranty acknowledged by the homeowner and the builder.

Sets forth provisions for the approval and use of a third-party warranty company.

Sets forth provisions regarding arbitration of a dispute between a homeowner and a builder that involves an alleged construction defect.

Requires TRCC to appoint a task force to study residential arbitrators and arbitration and advise TRCC with respect to residential arbitrators and arbitration.

Sets forth provisions regarding residential construction liability and offers of settlement.

**H.B. 1338 by Representative Taylor/Senator Averitt.** Relating to the amount of homeowners insurance or other residential property insurance required in connection with certain financing arrangements.

Prohibits a lender, as a condition of financing a residential mortgage or providing other financing

arrangements for residential property, including a mobile or manufactured home, from requiring a borrower to purchase homeowners insurance coverage, mobile or manufactured home insurance coverage, or other residential property insurance coverage in an amount that exceeds the replacement value of the dwelling and its contents, regardless of the amount of the mortgage or other financing arrangement entered into by the borrower.

Prohibits a lender from including the fair market value of the land on which a dwelling is located in the replacement value of the dwelling and its contents.

### S.B. 310 REPORT TO 78<sup>TH</sup> LEGISLATURE

Below are the key points excerpted from *S.B. 310: Summary Report for the 78<sup>th</sup> Legislature*, the final report to the legislature required by S.B. 310, published by TDI on March 28, 2003, and available at TDI's website: [www.tdi.state.tx.us](http://www.tdi.state.tx.us).

*Insurance rates are determined by the sum of expected property losses, expenses, and profit targets. The largest of these components is property losses. Reductions in investment income have not had a large impact on rates.*

*Rates in 2003 appear to be leveling off. Barring any further destabilization of the market, [TDI] anticipates this trend to continue on a broad scale, if not improve. Individual company rates, however, may behave differently than the norm.*

*Individual company rates could be reduced anywhere from zero percent to 25 percent from their current rates. [TDI's] analysis suggests that the companies reviewed are evenly distributed within this range. External parties have not reviewed [TDI's] findings; discussion with industry, consumer groups, and independent reviewers may provide differing actuarial analysis.*

*[TDI's] determination of how much rates might be excessive is based primarily on three factors: 1) loss trend assumptions; 2) target net rate of return, or profit, when calculating the premiums; and 3) accounting for coverage differences and the corresponding reduction in risk exposure.*

*Upon a more comprehensive review and additional information, our revised estimate is that homeowners' rates have increased statewide an average of 45 percent since 2000. A portion of the increase would have occurred under a rate-regulated market due to deterioration in experience, even in the absence of mold claims. The increase would have been at least 65 percent over 2000 without [TDI's] actions on increasing coverage options to allow flexibility in meeting consumers' needs.*

*Rates for tenants (renters), condos, and dwelling fire (a policy similar to a homeowners' policy without liability coverage) have gone up by 12 percent, 36 percent, and 54 percent respectively since 2000.*

*Credit scoring has had a significant impact on the rates charged individual policyholders within a company. With credit scoring, some policyholders will experience rate increases while others will see their rates go down. Overall, the company should collect the same amount of premium when credit scoring is used.*

*Most companies did not include a provision for reinsurance costs in their calculation of rate level needs. For those that did, the provisions ranged from two percent to nine percent which would increase rate levels by approximately the same amount.*

### Implementation

TDI began working on implementation of the new reform measures immediately following adjournment of the 78<sup>th</sup> Legislature, Regular Session. Rate reviews were completed on August 8, 2003, for the top 32 companies representing nearly 95 percent of the Texas homeowners insurance market, and on September 9, 2003, for the remainder of the market. Through its review, TDI concluded that the rates of 29 of the 61 companies examined were excessive. Those 29 companies were ordered to lower their homeowners insurance rates. TDI reported that the rate reductions ordered varied between zero and 31 percent and estimated that the reductions will save Texas consumers more than \$510 million.

Twelve of the 29 companies that were ordered to reduce rates appealed TDI's rate order. Ten of those companies later withdrew their appeals, having reached settlements with TDI. The settlements generally included a combination of rate reductions and refunds. On September 12, 2003, TDI ruled on the remaining appeals filed by State Farm Lloyds Insurance and Farmers Insurance Companies (two of Texas' largest homeowners insurers) and upheld the rate reductions ordered on August 8, 2003. Both State Farm and Farmers have appealed TDI's decision to state district court in Travis County.

—by Jeremiah Jarrell, SRC

### SENATE RESEARCH CENTER INSURANCE RESOURCES

The following Senate Research Center publications serve as additional sources of information on legislative matters and issues affecting homeowners insurance in Texas. These publications are available online at: [www.senate.state.tx.us/SRC/Pub.htm](http://www.senate.state.tx.us/SRC/Pub.htm)

*Highlights of the 78<sup>th</sup> Texas Legislature, Regular Session – July 2003*

*In Brief: Does Credit History Equal Insurance Risk? – February 2003*

*Research Matters: Mold - Good, Bad, and Ugly – December 2001*